Delaware phases in single sales factor and makes other tax filing changes

Overview

On January 27, 2016, Governor Jack Markell signed into law the Delaware Competes Act of 2016 (Act),[1] which phases in single sales factor apportionment for purposes of Delaware's corporation income tax (CIT), with certain exceptions. The Act also increases various gross receipts tax and employer withholding filing thresholds and changes CIT estimated payment requirements for certain taxpayers in an effort to simplify compliance for smaller businesses.

This Tax Alert summarizes the Act, including apportionment changes and smaller business filing implications, as well as discusses some related taxpayer considerations.

Apportionment

Historically, Delaware has maintained an equally weighted three-factor apportionment percentage consisting of property, payroll, and sales for CIT purposes.[2] The Act amends the CIT apportionment statute to gradually phase in single sales factor apportionment commencing in 2017 as follows:

- For tax years beginning in 2017, corporations generally must use a double-weighted sales factor;
- For tax years beginning in 2018, the sales factor is generally weighted three times;
- For tax years beginning in 2019, the sales factor is generally weighted six times; and
- For tax years beginning in 2020 and thereafter, corporations must generally use a single sales factor.

However, commencing in tax year 2017, the Act provides that taxpayers meeting the definition of a "Telecommunications Corporation" or "Worldwide Headquarters Corporation" are not subject to this single sales factor phase-in schedule and, instead, may annually elect to use either single sales factor apportionment or equally weighted three-factor apportionment consisting of property, payroll, and sales factors divided by three to compute their CIT liability.

The Act does not change Delaware's statutory requirement to allocate certain categories of income.[3] The Act also does not alter the determination of the sales factor; however, the Act specifies that payroll and property data used to calculate apportionment factors for corporations organized under the laws of foreign countries must only include US property and payroll. Further, the Act does not amend the existing apportionment rules applicable to a taxpayer meeting the definition of an "Asset Management Corporation" under 30 Del. Code § 1901(2).

Smaller businesses

The Act makes adjustments to certain gross receipts tax and employer withholding reporting thresholds and CIT estimated payment requirements, apparently with the intent to simplify compliance for smaller businesses. To this end, the thresholds for determining monthly versus quarterly filing requirements for gross receipts tax purposes have generally been doubled, and the thresholds for determining the frequency of filing employer withholding tax returns have also been increased. Prospectively, certain filing thresholds will also now be indexed for inflation based on changes in the US Consumer Price Index. Additionally, the Act allows businesses with receipts less than $20 million (indexed for inflation) to utilize an evenly weighted tentative estimated tax liability schedule (i.e., 25 percent of the estimated tax liability per quarter) in lieu of the standard requirement of 50 percent/20 percent/20 percent/10 percent for the first through fourth quarters, respectively.

Considerations

The Act creates some new taxpayer considerations related to domestic versus foreign corporations, as well as for smaller businesses. In this respect, taxpayers may need to reevaluate their potential CIT exposure as Delaware generally phases in single sales factor apportionment through 2020. Those taxpayers that may fall under the newly defined "Telecommunications Corporation" or "Worldwide Headquarters Corporation" classifications may need to consider whether it would be more beneficial to elect single sales factor apportionment when it becomes available

[1] HB 235, 148th Leg., 1st Reg. Sess. (Del., 2016).
[2] 30 Del. Code § 1903(b)(6).
[3] As provided by 30 Del. Code § 1903(b)(1)-(5).

in 2017, or simply remain subject to equally weighted three-factor apportionment. Foreign corporations must additionally ensure that they are utilizing only US property and payroll amounts when calculating their CIT apportionment factors. Lastly, smaller businesses may need to review their gross receipts tax, employer withholding and CIT compliance requirements in light of the increased filing thresholds and simplified estimated payment requirements under the Act.

Contacts

If you have questions regarding the Act or other Delaware tax matters, please contact any of the following Deloitte Tax professionals:

Kenneth Stoops	Steven Thompson	Stacy Ip-Mo
Director	Director	Senior Manager
Deloitte Tax LLP, Philadelphia	Deloitte Tax LLP, Philadelphia	Deloitte Tax LLP, Philadelphia
+1 215 299 5225	+1 215 246 2463	+1 215 246 2374

The authors of this Tax Alert would like to acknowledge the contributions of Alyssa Keim to the drafting process. Alyssa is a tax consultant working in the Philadelphia Multistate Tax practice of Deloitte Tax LLP.

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